

**Empowerment Zone Development Corporation
of the City of Detroit**

Financial Related Audit

February 2001



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June 1, 2001

Honorable City Council
Detroit, Michigan

**RE: Submission of the following report: Financial Related Audit of the
Empowerment Zone Development Corporation of the City of Detroit, dated
February 2001**

The Office of the Auditor General submits, herewith, the above-captioned report to the City Council. The audit was requested by the Board of Directors Human Resources Committee of the Empowerment Zone Development Corporation (EZDC). Following is a description of the accompanying report.

**Empowerment Zone Development Corporation
of the City of Detroit**

Our report contains seven recommendations: one each relates to improving controls over purchases and procurements, reimbursing the City for the overpayment of Title XX reimbursements, improving internal controls over cash receipts and cash disbursements, improving accountability and controls for fixed assets, repaying the City for advances, depositing funds in an interest bearing bank account, and accounting for a small grant received from the U.S. Department of Commerce.

Management of the EZDC indicates that it will take action or already has taken action to implement most of the recommendations.

Respectfully submitted,


Joseph L. Harris
Auditor General

Attachment

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Table of Contents

	<u>Page</u>
Executive Summary	i
Audit Objectives, Scope, And Methodology	1
Background	2
Findings and Recommendations	
1. Overpayment of Title XX Reimbursements	3
2. Need to Improve Internal Controls for Procurements and Disbursements	5
3. Excessive Advances Made to EZDC	8
4. Other Internal Control Weaknesses Over Cash Receipts and Disbursements	9
5. EZDC Funds Need to be Maintained in an Interest Bearing Account	11
6. Need to Improve Controls Over Fixed Assets	12
7. Department of Commerce Grant Funds Not Properly Accounted For	13
Empowerment Zone Development Corporation's Responses	Attachment

EXECUTIVE SUMMARY

Introduction

This report contains the results of our financial related audit of the Empowerment Zone Development Corporation (EZDC) of the City of Detroit, performed in February 2001.

Audit Purpose:

The Office of the Auditor General (OAG) conducted a financial related audit of the EZDC to determine whether internal accounting controls were in accordance with the EZDC's contract with the City of Detroit, requirements of the Federal Government, and generally accepted accounting practices, and to make recommendations for improvements where appropriate.

Background

The Board of Directors Human Resources Committee of the EZDC requested that the Office of the Auditor General perform an audit to determine whether proper accounting procedures and internal controls were in place.

Overall Conclusion

We identified several weaknesses in internal controls, which have resulted in conditions such as overpayments of Empowerment Zone Social Service Block Grant (EZ SSBG) funds by the City, and excessive accumulation of funds, questionable payments for professional services, poor accountability of fixed assets, and lack of timely deposit of cash receipts by the EZDC. A summary of our findings and recommendations follows.

Summary of Findings

1. The EZDC was reimbursed by the City for expenses that were paid for by contributions from private sources. These included restrictive contributions, fund raising revenues, and contributions for general operations. As a result, the EZDC has been overpaid by the City and the amount of net assets of the EZDC is greater than it should be, as is the risk for misuse of the excess funds.
2. The EZDC does not utilize purchase orders or receiving reports, and does not always prepare written contracts when contracting for professional services. In addition, existing contracts were not amended for changes such as fee increases or for extensions beyond the expiration date. Further, contracts are not properly monitored to ensure invoiced fees and services are in agreement with the contract. As a result, the EZDC lacks assurance that goods and services procured are properly authorized, received in good condition, and billed and paid at correct and reasonable rates.
3. The City has made excessive advances to the EZDC. As of December 31, 2000, the EZDC had a balance of \$306,474 in advances due the City and its reconciled bank balance was \$257,237. The EZDC has an excessive amount of funds, which increases the risk for misuse.
4. We also noted the following internal control weaknesses related to cash receipts and disbursements:
 - Written procedures to provide needed internal controls have not been completed.

- The accountant performs incompatible duties, including generation of checks, recording of accounting transactions, and performance of bank reconciliations.
 - Deposits are not always made on a timely basis, i.e., within 48 hours of receipt.
 - Accounts receivable, advances payable, and other balance sheet items were not accurately reported on the monthly balance sheets.
 - Checks were issued out of sequence.
5. The EZDC does not deposit its Title XX reimbursements, advances, and other revenue in an interest bearing account, which results in lost interest income.
 6. The EZDC does not tag its fixed assets or conduct periodic inventories of them. In addition, fixed assets and depreciation expenses are not properly posted to the general ledger. As a result, accountability for fixed assets is weak and there is no assurance that fixed assets are properly safeguarded. In addition, fixed assets, accumulated depreciation, and depreciation expense are not accurately reported on the EZDC's monthly financial statements.
 7. The EZDC's administrative costs for the Minority Business Opportunity Committee (MBOC), a U.S. Department of Commerce funded program, were not properly accounted for and Title XX Empowerment Zone Social Service Block Grant Funds were used to reimburse the EZDC for this program. As a result, the Title XX grant was overcharged by the amount of the EZDC administrative costs for the MBOC program.

Summary of Recommendations

We recommend the EZDC take action to:

1. Reimburse the City for overpayments and unused contributions, and in the future, deduct the amount of contributed funds, revenue generated from fundraising, and other miscellaneous revenue from its reimbursement requests to the City.
2. Require a purchase order for each purchase greater than \$2,000 a year and prepare written contracts for all professional services such as accounting, legal, media relations and management information systems; in addition, require receiving reports for all goods and services purchased, and match invoices with purchase orders or contracts and receiving reports to ensure goods and services are properly authorized, received in good condition, and are properly charged on the invoice.
3. Establish a more rapid schedule for repayment of advances made by the City and properly report outstanding advances due the City.

4. Improve internal controls over cash receipts and disbursements by:
 - A. Completing and implementing the EZDC procedural manual;
 - B. Assigning an employee independent of the accountant to generate checks for cash disbursements;
 - C. Depositing cash receipts within 48 hours of receipt;
 - D. Maintaining subsidiary ledgers for all balance sheet accounts and reconcile them monthly to the general ledger control accounts; and
 - E. Issuing all checks in sequence.
5. Open an interest bearing bank account and deposit available funds into it.
6. Tag all fixed assets to identify the property as owned by the EZDC and City of Detroit and conduct a physical inventory immediately and at least once every year thereafter; in addition, create a subsidiary record for each fixed asset and reconcile such records to the general ledger control accounts, and determine the correct amounts for the fixed asset, accumulated depreciation, and depreciation expense accounts.
7. Account for non-Title XX grants separately; in addition, determine the costs incurred for the Minority Business Opportunity Committee (MBOC) program and deduct such costs from the reimbursement request to offset overpayment of Title XX funds.

AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

Audit Objectives

Our overall audit objective was to determine whether the EZDC's internal accounting controls are adequate.

Specific audit objectives were as follows:

1. To determine whether the EZDC maintains adequate internal accounting controls for its cash and other assets.
2. To determine whether internal accounting controls specified by the City Charter, City of Detroit contract, and United States Office of Management and Budget (OMB) Circular A-110 were in place and functioning satisfactorily.

Audit Scope

We reviewed, tested, and evaluated the EZDC's internal accounting controls for cash and other assets. We examined a sample of transactions for the period from July 1, 1998 to December 31, 2000. We also interviewed EZDC employees, several of the EZDC's Board of Directors, and City of Detroit Planning and Development Department employees.

The audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States and accordingly included such tests of the records and other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

To accomplish our audit objectives, our audit work included the following:

- We reviewed the EZDC contract with the City, the City Code as it applies to the Empowerment Zone Development Corporation, Federal requirements (OMB circulars A-110 and A-122), previous audit reports, and other information deemed necessary to gain an understanding of the EZDC's internal accounting controls. We also interviewed EZDC management.
- We evaluated internal accounting controls for cash receipts, including the City's reimbursement of eligible costs, contributions, fund raising revenue, and other revenue received by the EZDC.
- We evaluated internal accounting controls relating to financial reporting.
- We evaluated internal accounting controls for the purchasing function, examining contracts for professional services and other purchases.
- We evaluated internal accounting controls for disbursements, examining payroll, invoices, and contract disbursements.
- We evaluated internal accounting controls for fixed assets.
- We evaluated internal accounting controls over advances/loans from the City and private sources, and requests for reimbursement from the City for eligible expenses.
- We determined the net assets of the EZDC and the sources of increases to net assets.
- We examined a small judgmental sample of transactions, which we considered satisfactory to achieve our objectives.

BACKGROUND

On December 21, 1994, the Secretary of the U.S. Department of Housing and Urban Development designated a portion of the City of Detroit as an empowerment zone, which as detailed in its strategic plan, is designed to stimulate the creation of new jobs for the disadvantaged and the long-term unemployed and to promote revitalization of economically distressed areas within the empowerment zone.

The Detroit City Code in Chapter 14, Article X provides for the Empowerment Zone Development Corporation (EZDC). The purpose of the Empowerment Zone Development Corporation is to coordinate, review, recommend prioritization of, monitor, and evaluate the programs of implementing agencies in the empowerment zone to ensure the achievement of benchmarks and timetables as detailed in the strategic plan through a genuine partnership among business, the community, and government. The United States Department of Housing and Urban Development (HUD) requires the EZDC to report the performance, accomplishments and progress of implementing the benchmarks of each empowerment zone program to HUD on an annual basis.

The City of Detroit's Planning and Development Department (PDD) contracted with the EZDC on April 16, 1997 to provide the services noted above. This contract will expire June 30, 2001.

The EZDC and empowerment zone programs are funded by \$100 million in Title XX Empowerment Zone Social Service Block Grant Funds (EZ SSBG Funds), which under the strategic plan covers the ten-year period from January 1, 1995 to December 31, 2004. The United States Department of Health and Human Services (HHS) awarded EZ SSBG Funds to the Michigan Department of Social Services (DSS), which serves as a fiscal intermediary by subgranting these funds to the City's Planning and Development Department, as the lead entity. PDD has agreed to pay the EZDC, as the subrecipient, on a cost reimbursement basis, an amount up to \$3,601,890 in EZ SSBG funds for the complete and proper performance of services as set forth in the contract.

The EZDC has a fifty-member board of directors comprised of members from various segments of the community. Additionally, the fifty-member board has a twenty-five member Executive Committee elected from within its ranks, which is the governing body of the Corporation.

The EZDC is required to provide the Mayor and the City Council with quarterly performance reviews of the Empowerment Zone's activities. The EZDC is also required to provide the Mayor, the City Council, and the Auditor General with monthly financial reports.

FINDINGS AND RECOMMENDATIONS

1. Overpayment of Title XX Reimbursements

The EZDC was reimbursed from the Title XX Empowerment Zone Social Service Block Grant (EZ SSBG) funds for expenses that were paid for by contributions from private sources. These private sources included restrictive contributions, fund raising revenues, and contributions for general operations. As a result, the EZDC has been overpaid and the amount of net assets of the EZDC is greater than it should be, as is the risk for misuse of the excess funds.

The contract (City contract 2529275) between the EZDC (subrecipient) and City of Detroit, dated April 18, 1997, which provides for reimbursement of EZDC's costs with Title XX Empowerment Zone Social Service Block Grant Funds, requires in paragraph 6.08 that "The subrecipient shall not charge to this agreement direct costs which have been or will be paid from another source or submitted to or will be submitted to another source."

Exhibit A (Scope of Services) of the contract also states, in part, "Direct costs charged by EZDC to any one funding source shall not be charged to any other funding source." Exhibit A further states, "The EZDC shall hold a fund raising activity to support administrative functions, but costs related thereto are not allowable under this agreement." Exhibit C (Accounting and Bookkeeping Procedures and Requirements), paragraph 1, states, "Expenses paid or payable from sources other than this agreement shall be excluded from the agreement general ledger account and shall not be included in the monthly requests for reimbursement payment."

Section 14-10-4 of the City Code, paragraph (b) (3) provides the EZDC with the powers and duties for "soliciting and accepting gifts, donations, in-kind services, grants, loans, appropriations or other funds for operating expenses from federal, state, local and private sources".

Detailed below are the overpayments, totaling \$41,900 through June 30 2000, for expenses of the EZDC paid for with contributions and revenues generated from fund raising, which were also reimbursed by the City with Title XX funds:

<u>Month/Year</u>	<u>Purpose</u>	<u>Total Expenses</u>	<u>Contributed Revenue</u>	<u>Reimbursed By Title XX</u>	<u>Overpaid By Title XX</u>
December 1998	Temporary Clerical	\$12,705	\$12,705	\$12,705	\$12,705
June 2000	Five Year Report	46,490	21,775	43,990	19,275
August 2000	Posters	3,559	3,559	3,559	3,559
November 2000	First Luncheon	<u>22,411</u>	<u>29,585</u>	<u>6,361</u>	<u>6,361</u>
Total		<u>\$85,165</u>	<u>\$67,624</u>	<u>\$66,615</u>	<u>\$41,900</u>

We also noted that the net asset amount of the EZDC increased each of the past three years, which indicates that contributions were not utilized to fund operations, as intended, and/or that the EZDC was reimbursed EZ SSBG funds in excess of its eligible expenses. The reimbursements should be less than or equal to EZDC's expenses. Since the EZDC has incurred ineligible expenses for interest from loans and certain board of director expenses, the cumulative amount of the EZDC's Title XX

reimbursements should be less than its cumulative expenses, and we could expect net assets to decrease.

The schedule which follows, presents the net asset amounts reported at the end of each of the past five fiscal years and the increase or decrease from year to year:

<u>Fiscal Year</u> <u>Ended June 30</u>	<u>Amount of</u> <u>Net assets</u>	<u>Increase</u> <u>(Decrease)</u>
1996	\$ (20,831)	\$ (20,831)
1997	(41,909)	(21,078)
1998	72,698	114,607
1999	109,539	36,841
2000*	169,465	59,926

* Based on EZDC draft financial report, as the final independent auditor's report was not completed at the time of our audit.

The purchase of fixed assets will cause net assets to increase because the associated costs are reimbursable when incurred and capitalized on the books. The EZDC's net assets should equal approximately the amounts of undepreciated fixed assets and unutilized contributions. Undepreciated fixed assets, at June 30, 2000, totaled \$50,707. We estimate that \$118,758 (net assets of \$169,465 less undepreciated fixed assets of \$50,707) of the EZDC's net assets, as of June 30, 2000, includes the \$41,900 overpaid by the City to the EZDC (as previously noted) plus accumulated contributions that were not utilized to pay for EZDC expenses, as required. The EZDC has a responsibility to raise private funds to pay interest costs and support operations.

The EZDC received \$75,000 and \$125,000 of contributions for general operations for the fiscal years ended June 30, 1997 and 1998, respectively. However, it does not appear that all of the contributed funds were applied to operations.

The EZDC and the City (i.e., the Planning and Development Department) are not monitoring the EZDC's net assets and contributions. In addition, the EZDC is not reporting the funds contributed to it, revenue generated by fund raising, or other miscellaneous revenue on its monthly Budgetary Status Report to the City. The City uses this report to compute the amount of the reimbursement to the EZDC. As a result, expenses that should be paid by these revenues are reimbursed by the City to the EZDC.

Recommendation

We recommend that the EZDC take the following actions:

- A. Deduct the amount of overpayments, totaling \$41,900 through June 30, 2000, made by the City to the EZDC and unused contributions (reflected in the net assets) from the request for future reimbursements.
- B. In the future, deduct contributions, revenue generated from fund raising, and other miscellaneous revenue from reimbursement requests made to the City in the period received, unless restricted for a specific purpose in the future.

- C. Include the amounts of contributed funds, revenue generated by fund raising, and other miscellaneous revenue on the monthly Budgetary Status Report. A balance sheet including the net assets should also be submitted to the City. These items need to be monitored for improved cash control.

2. Need to Improve Internal Controls for Procurements and Disbursements

The EZDC needs to improve its internal accounting controls for procurements and disbursements. The EZDC does not utilize purchase orders or receiving reports, and does not always enter into written contracts for professional services. Also, existing contracts were not amended for changes, such as fee increases or extensions beyond the expiration date. In addition, contracts are not properly monitored to ensure invoiced fees and services are in agreement with the contract. As a result, the EZDC lacks assurance that purchased goods and services are properly authorized, received in good condition, and costs are reasonable and billed at the correct rate.

Good internal accounting controls require the use of written contracts, including purchase orders, to control costs and purchases. They help ensure orders for goods and services are properly authorized and approved, and funds are budgeted and available. Contracts and purchase orders provide legally binding terms for the purchase of goods and services. In addition, they provide documentation, protection, and assurance to each of the contracting parties that each party is providing or receiving the goods, services or fees agreed to. Contracts and purchase orders are also important in the payment process to ensure that invoiced amounts and fees agree with the contract.

The absence of written contracts with detailed specifications and deliverables for professional services, such as a management information system and legal services, increases the likelihood of poor delivery of services, excessive payments, and disputes. In addition, written contracts often provide legal remedies for failure to satisfactorily deliver contracted goods and services.

OMB Circular A-110, the Uniform Administrative Requirements for Grants and Agreements with Non-Profit Organizations, requires specific contract provisions such as termination clauses and legal remedies for contracts exceeding the small purchase threshold of \$25,000. In addition, OMB Circular A-110 states, in paragraph 44 (c), "The type of procuring instruments used (e.g., fixed price contracts, cost reimbursable contracts, purchase orders, and incentive contracts) shall be determined by the recipient but shall be appropriate for the particular procurement and for promoting the best interest of the program or project involved."

We noted the following internal accounting control weaknesses related to the procurement and disbursement processes of the EZDC:

- Purchase orders are not utilized.
- Failure to ensure funds are budgeted and available prior to placing order for goods and services.

- Receipt of goods and services are not documented.
- Lack of formal contracts for management information system and legal services.
- The contract for professional accounting services was not formally amended for a fee increase of \$1,000 per month.
- Excessive fees were paid for bank reconciliation work.
- The contract for media-relations was not properly monitored for payment of fees.
- The contract for media-relations was not amended to extend the contract expiration date even though services provided after the expiration date were invoiced.
- Contracts were not reviewed by an attorney to ensure required provisions were included and the EZDC's interests were protected.

EZDC personnel order goods and services without generating approved purchase orders. There is no established formal procedure for approving purchase requests, ensuring that funds are budgeted and available, and generating purchase orders prior to ordering goods and services. As a result, there is no assurance that procured goods and services are properly authorized and that funds are budgeted and available to pay for them.

The EZDC does not utilize receiving reports or document the receipt of goods and services for invoices that it pays. There is no evidence of a system to assure that the goods and services were received and in good condition before payment of invoices.

An effective internal accounting control over disbursements is to match purchase orders with receiving reports and invoices to ensure goods and services are properly authorized, satisfactorily received or performed, and fees are properly charged on the invoices. Currently, the EZDC lacks such control because it does not utilize purchase orders and receiving reports.

A formal contract was not prepared for the management information system developed for the EZDC to better monitor its programs. As noted previously, OMB Circular A-110 requires specific provisions for contracts exceeding \$25,000. A proposal was developed by the vendor, which included an estimate of 860 hours at \$75 per hour for a total of \$64,500. An invoice was paid for \$19,875 (265 hours X \$75 per hour per the proposal) in November 2000. Cumulative costs for the management information system were overbudget by \$18,875, at November 30, 2000. Without a formal contract, the EZDC must rely on the contractor's integrity to develop and deliver a good management information system at a fair price.

The EZDC did not have a formal contract for legal services. We noted that fees varied for the same lawyer for the same type of legal service (i.e., conference calls and review of EZDC documents) provided. Fees ranged from \$228 (October 2000 invoice) to \$285 (August 2000 invoice) per hour. It appears the EZDC has overpaid legal services. The

EZDC paid a total of \$36,313 for legal services from this law firm during the period July 1, 1998 to December 31, 2000.

The fees for professional accounting services increased from \$2,200 per month (billed February to June 2000) to \$3,200 per month (billed July to December 2000). However, the professional accounting services contract was not formally amended for the increase. As a result, there is a lack of assurance that the fee increase was properly authorized. The contract specified "The fee for the above services will range from \$2,200 per month, payable bi-weekly at the time the documents are delivered for processing. The fee will remain at this level through December 31, 2000. Beginning with January, 2001 processing, I [Accountant] will evaluate the time actually spent on this work in relation to the fixed-fee arrangement." The accountant told us that the EZDC Executive Director verbally approved an increase in fees because of the addition of two new programs (Community Based Delivery System and Innovation Fund), which required additional accounting work. Check requests with signed approval by the Executive Director for the \$3,200 monthly fee support this. Good internal accounting controls require that contracts be amended in writing to ensure the changes are readily available to all interested parties, properly authorized, and documented in the contract.

The EZDC paid the accountant relatively large fees to perform routine bank reconciliations for the ten months from July 1999 to April 2000. The fees paid totaled \$3,375 for 27 hours at \$125 per hour. We contacted a temporary accounting personnel service, which told us it would charge a company \$31, or \$94 less, per hour to perform bank reconciliations. The professional accounting services contract stated "No service outside the scope of accounting identified above [i.e., monthly fee] are included in this fee." Additional services outside the scope identified would be charged at the rate of \$125 per hour. Bank reconciliations for February, March and April 2000, totaling 3 hours and \$375, should have been covered within the scope of the monthly services fee of \$2,200 per the contract (paragraph 4 of the monthly services section). In addition, a \$650 fee was paid on March 22, 2000 for initial set up cost, which could be interpreted to include bank reconciliations from prior periods. There was no documentation such as a contract amendment or purchase order to support the EZDC's approval of the bank reconciliation work prior to being invoiced and paying for the work. This further substantiates the need for the EZDC to improve controls over the procurement of professional services.

The EZDC is not properly monitoring payments for its media-relations services. The contractor would have been overpaid if a stop payment had not been made in January 2001 for a check issued on June 30, 2000 in the amount of \$10,994 for services provided in April, May and June 2000. A retainage of \$14,721 was paid to the contractor in June 2000, but was not properly accounted for. The retainage was an advance of one-third the contract and should have been deducted from subsequent invoiced amounts until fully recovered. However, the EZDC paid the full amount of the subsequent invoices without deducting the retainage. If the EZDC pays the \$10,994 for April through June 2000 services and continues paying the full amount of the invoices it will end up overpaying the contractor by \$14,721, the amount of the retainage. The EZDC needs to establish a payment history that shows the contracted amount, amount invoiced, amount paid, amount of any retainage, and the balance remaining to ensure it does not overpay the contractor.

The media-relations contract should have expired in October 2000. However, the contractor has continued providing the services and submitted invoices for November and December 2000. The EZDC needs to terminate the contract or amend it to extend the expiration date to continue the services. The EZDC has a communications manager doing media-relations and should seriously consider terminating the contract.

The EZDC does not have an attorney review its contracts. As a result, there is a lack of assurance that contracts are properly prepared, include federally required provisions, and adequately protect the interests of the EZDC.

Recommendation

We recommend the EZDC improve internal accounting controls over procurements and disbursements by implementing written procedures which require:

- A. Written purchase orders or contracts for all goods and services, including professional services such as accounting and legal services, that will cost over \$2,000 (i.e., City of Detroit purchasing regulations require purchase orders for each purchase greater than \$2,000) per year.
- B. Review of procurement requests by the Executive Director or accountant to ensure funds are budgeted and available.
- C. Formal amendments and the Executive Director's approval of changes to contracts.
- D. Professional service contracts to include hourly fees, number of hours of work to be done for each contracted service, or the specific services to be rendered, and total contract amount.
- E. Preparation of receiving reports, or similar documentation such as signing and dating packing slips, upon the receipt of goods and services.
- F. Matching invoices with purchase orders or contracts and receiving reports to ensure goods and services are properly authorized, received in good condition, and are properly charged on the invoices before authorizing payment.
- G. Attorney review of contracts over \$25,000 to ensure they include required provisions, and that the EZDC's interests are protected.

3. Excessive Advances Made to EZDC

Based on Federal grant requirements and the contract between the City and the EZDC, the City has made excessive advances of funds to the EZDC. Excessive advances increase the opportunity and risk for a misuse of funds.

As of December 31, 2000, the EZDC had a balance of \$306,474 in advances due the City of which \$209,474 has been outstanding for more than 120 days, including \$35,000

due from an advance made in October 1998. The \$306,474 of advances represented more than the total of the three months of the EZDC's reimbursement requests to the City, for the period from October to December 2000.

OMB Circular A-110, the Uniform Administrative Requirements for Grants and Agreements with Non-Profit Organizations, paragraph 22 (b), requires "Cash advances to a recipient organization shall be limited to the minimum amounts needed and be timed in accordance with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project."

Exhibit J of the contract between the EZDC and the City requires that the balance of advances due the City be reported on the Budgetary Status Report in the "Budget Balance" column. Paragraph 6.01 of the contract states "For any month in which a reimbursement is scheduled to be paid, the subrecipient may, when necessary, request an advance amount in addition to any amount scheduled for reimbursement when such reimbursement amount is insufficient for the estimated disbursement needs for that month. The subrecipient shall include adequate documentation acceptable to the City with each such advance request. The subrecipient shall ensure that such additional advance amounts are as close as is administratively feasible in regard to timing and amount to the actual cash outlay by the subrecipient for direct program costs and the proportionate share of any allowable indirect costs."

The City's Planning and Development Department has not established a repayment schedule for the advance amounts it has paid to the EZDC. The EZDC determines the amount to repay each month based on its projected cash flow needs. In November and December 2000, the EZDC reduced its reimbursement requests, which totaled \$179,493, by \$4,000 each month (\$8,000 in total) to repay part of the advances. This repayment schedule is not sufficient. The EZDC has enough cash on hand to repay the advances more rapidly. In addition, the EZDC is not properly reporting the advances on its reimbursement request (Budgetary Status Report), as required by the contract between the City and the EZDC.

Recommendation

We recommend the City's Planning and Development Department establish a schedule, which requires a more rapid repayment of advances made by the City to the EZDC. We also recommend that the EZDC properly report its outstanding advances due the City on the monthly Budgetary Status Report. Furthermore, we recommend that the EZDC be required to prepare cash flow forecasts and not be allowed advances in excess of its projected needs.

4. Other Internal Control Weaknesses Over Cash Receipts and Disbursements

We noted the following internal control weaknesses related to the EZDC's cash receipts and cash disbursements:

- Written procedures, which provide needed internal controls, have not been completed.

- The EZDC accountant performs the incompatible duties relating to generating checks, recording transactions, and preparing bank reconciliations.
- Deposits are not always made on a timely basis, i.e., within 48 hours of receipt.
- Accounts receivable, advances payable, and other balance sheet account items were not accurately reported on the EZDC's monthly balance sheets.
- Checks were issued out of sequence.

Written procedures, which provide needed accounting and other internal controls, have not been completed. A manual of procedures is in the draft stages. Written accounting procedures would provide EZDC's management and personnel with guidance for implementing effective internal controls. OMB Circular A-110, the Uniform Administrative Requirements for Grants and Agreements with Non-Profit Organizations, paragraph 44, requires "All recipients shall establish written procurement procedures." Exhibit C, section II, paragraph 1 of the EZDC contract with the City requires "Employee responsibilities shall be formalized."

Duties for generating checks, recording accounting transactions, and preparing bank reconciliations are all performed by the accountant. This is too much independent control over cash for one person. Without sufficient separation of duties for cash disbursements, any errors or irregularities are more likely to go undetected. Exhibit C, section II, paragraph 1 of the contract requires "Employees who handle or record cash or prepare or sign checks shall not also reconcile bank statements to accounting records." The generation of checks should be done by another employee independent of the accountant.

Cash receipts are not always deposited within 48 hours of receipt, which is considered a reasonable and timely basis under the City's Finance Directive No. 18. Almost all of the EZDC's cash receipts are in the form of checks. Delaying the deposit of cash receipts results in greater exposure to risks, such as misplacement and theft, as well as lost interest income. An effective control for safeguarding cash receipts includes depositing them on a timely basis.

At times, balance sheet accounts such as accounts receivable, fixed assets, advances payable, and accounts payable are not accurately reported at month end. We reviewed the November 30, 2000 balance sheet and found that only the cash account was correctly stated on the balance sheet. Other accounts, such as accounts receivable, were incorrectly reported because of errors, such as not reversing prior year accruals. The EZDC does not maintain subsidiary ledgers as support for the general ledger accounts. Exhibit C, section I, paragraph 3, of the City's contract with the EZDC requires "A General Ledger shall be established and maintained for all accounts affected by this agreement. The General Ledger shall be posted up-to-date at least once a month." Proper posting and effective accountability procedures include reconciling subsidiary ledgers to the general ledger control accounts to detect errors and ensure accurate recording and reporting.

We noted that five checks issued on October 31, 2000 were issued out of sequence. These checks were numbered 2222, 2223, 2225, 2226, and 2227. Check numbers

2221 and 2224 were issued on November 15, 2000. Issuing checks out of sequence indicates checks are not properly secured and accounted for, and possibly misplaced, lost, or stolen. Effective accounting control and procedures for unused checks include the proper physical safeguarding, issuing them in sequential order, and accounting for all voided and unused checks. Although we were able to account for all of the checks, the EZDC needs to implement procedures which ensure in the future that all checks are issued in sequential order.

Recommendation

We recommend the EZDC take the following actions to improve controls over cash receipts and cash disbursements:

- A. Complete the EZDC's procedural manual, distribute the manual to responsible staff, and implement the procedures.
- B. Assign an employee, independent of the accountant, to generate checks for cash disbursements. The EZDC accountant should not have access to any blank checks.
- C. Deposit cash receipts daily if possible, but no later than 48 hours after receipt.
- D. Maintain subsidiary ledgers for all balance sheet accounts and reconcile them to the general ledger control accounts each month to detect errors and ensure accurate recording and reporting of financial activity.
- E. Issue all checks in sequence by reviewing the check register for the last check issued before writing new checks.

5. EZDC Funds Need to be Maintained in an Interest Bearing Account

The reconciled bank balance of the EZDC, at December 31, 2000, was \$257,237, however, the EZDC does not deposit its funds in an interest bearing account. As a result, interest income is lost. If the EZDC deposited its funds in an interest bearing account earning 4% per year, interest income would be \$10,000 on an average annual balance of \$250,000.

The contract (City contract 2529275) between the EZDC (as a subrecipient) and the City of Detroit, dated April 18, 1997, which included cost reimbursement by Title XX Empowerment Zone Social Service Block Grant Funds states in Exhibit C, "if any Federal Funds are advanced under this Agreement, all contract funds shall be kept in interest bearing accounts." If total interest earned exceeds \$250 during the term of the agreement, the excess shall be promptly remitted to the City for submission to the Federal government. All City funded advances are also to be deposited in interest bearing accounts and all interest income is treated as program income. OMB Circular A-110, the Uniform Administrative Requirements for Grants and Agreements with Non-Profit Organizations, requires "Recipients shall maintain advances of Federal funds in interest bearing accounts."

The EZDC has not opened an interest bearing account or sought to invest excess funds. It usually does not have such a large cash balance, even having to borrow money in the past to support operations. The large balance is due mainly to excess advances granted by the City (see finding number three).

Recommendation

We recommend the EZDC open an interest bearing bank account and deposit all funds into an interest bearing account.

6. Need to Improve Controls Over Fixed Assets

The EZDC does not tag its fixed assets or conduct a periodic inventory of them. In addition, fixed assets and depreciation expenses are not properly posted to the general ledger. As a result, accountability for fixed assets is weak and fixed assets, accumulated depreciation, and depreciation expense are not accurately reported on the EZDC's monthly financial statements.

Exhibit C, section III, paragraph 2 of the EZDC's contract with the City requires "Items purchased with funds derived from this agreement shall be marked with an appropriate tag or label, and inventories of such property shall be taken no less than annually, and shall be updated upon the last day of this agreement." Good accounting practices require the maintenance of a subsidiary ledger for all fixed assets, which accounts for the date of purchase, estimated life, annual depreciation expense, accumulated depreciation, and undepreciated balance.

We observed that the EZDC's fixed assets, such as computers, did not have a tag or label to identify each as EZDC or empowerment zone property. An EZDC representative told us that an inventory of fixed assets has not been conducted.

The EZDC could not provide us with a listing of its fixed assets and did not maintain a subsidiary ledger for them. Fixed assets, as recorded on the general ledger, have not been updated since June 30, 1999. In addition, depreciation expense has not been recorded since June 30, 1999. There have been purchases of fixed assets since June 30, 1999, but they have been expensed and adjusting entries to capitalize them have not been made. The EZDC's fixed assets, accumulated depreciation, and depreciation expense are understated on the EZDC's monthly financial statements. Also, net assets will be understated by the amount of fixed assets expensed and overstated by the amount of depreciation expense not recorded.

Recommendation

We recommend the EZDC implement the following to strengthen internal accounting controls over fixed assets:

- A. Tag all fixed assets to identify the property as owned by the EZDC and City of Detroit.

- B. Conduct a physical inventory of fixed assets immediately, and once every year, and document the results. Note any missing or unmarked items and report inventory results to the EZDC's Executive Director.
- C. Create a subsidiary record for each fixed asset to include date of purchase, description, estimated life, monthly depreciation expense, accumulated depreciation, and undepreciated balance. Adjust expenses and net assets to properly record activity since June 30, 1999, and current balances.
- D. Reconcile the subsidiary ledger to the general ledger accounts for fixed assets, accumulated depreciation, and depreciation expense.
- E. Adjust monthly expenses to properly reflect depreciation expense.

7. Department of Commerce Grant Funds Not Properly Accounted For

The EZDC's administrative costs for the Minority Business Opportunity Committee (MBOC), a U.S. Department of Commerce funded program, were not properly accounted for and Title XX Empowerment Zone Social Service Block Grant (EZ SSBG) Funds were used to reimburse the EZDC for this program. As a result, Title XX EZ SSBG funds were overpaid to the EZDC by the amount of the EZDC's administrative costs for the MBOC program.

The EZDC's contract with the City in paragraph 4.09 states, in part, that the "Subrecipient [EZDC] shall not receive any payment from the City for any costs under this agreement, in addition to or in lieu of those set forth in, and pursuant to, the areas of cost and the maximum amounts thereof, as specified in the line items of Exhibit B, Budget". The administrative costs of the MBOC program were not budgeted. Paragraph 6.08 of the contract also states "the Subrecipient shall not charge to this agreement direct costs which have been or will be paid from another source or submitted to or will be submitted to another source." Exhibit C, section 3, paragraph 6, of the contract requires "Agreement funds shall be used only for specific agreement purposes." Exhibit A of the contract, requires "Direct costs charged by EZDC to any one funding source shall not be charged to any other funding source."

The EZDC was awarded a grant by the Department of Commerce in the amount of \$292,321 for the period December 1, 1997 to September 30, 1998 for the Detroit Minority Business Opportunity Committee (MBOC). The EZDC's role was to pass the grant funds through to the University of Detroit Mercy, which administered the grant and reimbursed the MBOC for its expenses. This grant required a local match of \$99,845, the majority to be provided by the University of Detroit Mercy and the MBOC, \$25,000 by the EZDC, and \$8,000 by the City of Detroit.

Since the Director of the MBOC program abandoned it in January 1999, and did not submit the necessary reimbursement request, the EZDC was forced to gather the necessary documents and submit them for reimbursements. The EZDC received a payment of \$71,944 from the U.S. Department of Commerce on June 22, 2000, as the final and only reimbursement for the grant. Another \$50 was deposited into the bank

account by the EZDC to establish the account and funds were disbursed from the bank account as detailed below:

<u>Check Payee</u>	<u>Date of Check</u>	<u>Amount</u>	<u>Purpose</u>
University of Detroit Mercy	October 23, 2000	\$67,285	Administration
One Stop Capital Shop	October 23, 2000	3,800	Rent
Butzel Long	October 23, 2000	420	Legal
Federal Express	October 23, 2000	68	Mail
Comerica	January 29, 1999	<u>20</u>	Service Charge
Total		<u>\$71,593</u>	

A total of \$401 remained in the EZDC bank account for the MBOC program, as of December 31, 2000.

The University of Detroit Mercy was not reimbursed for \$22,856 of its costs, since the EZDC did not have an indirect cost allocation plan for this program, and the University of Detroit's indirect costs of \$19,512 were disallowed. The University of Detroit Mercy also provided the entire \$35,564 required by the U.S. Department of Commerce for matching funds.

The EZDC did not account separately for its administrative costs for the MBOC program. The only documentation we found for the EZDC's administrative costs for the MBOC program was a letter, dated April 5, 2000, by the EZDC Executive Director to the EZDC Board of Directors. The letter stated that "EZDC has spent well over 200 hours in administrative time, 20 hours of volunteer time, funds for legal counsel, and funds to open a separate account." We estimate the EZDC's costs exceeded \$10,000. Most of the costs (salary and fringe benefits) were for the Executive Director's time. These costs were reimbursed from Title XX EZ SSBG funds. The U.S. Department of Commerce did not provide any reimbursement of the EZDC's administrative costs for the MBOC program.

We were informed by a Grants Officer of the U.S. Department of Commerce that the MBOC grant has been closed out and the EZDC has no further obligations, except that the Department of Commerce Inspector General could audit the program and the EZDC could be responsible for any disallowed costs. However, we were also told an audit was unlikely because of the small amount paid on this grant.

The EZDC did not properly review the MBOC program grant application to ensure its administrative costs would be eligible for reimbursement by the U.S. Department of Commerce. In addition, the EZDC did not account for its costs related to the MBOC program and could not document the costs to be reimbursed.

Recommendation

We recommend the EZDC refrain from participating in any non-Title XX grant programs in the future without first obtaining approval from the City of Detroit. In addition, if any other grants are awarded, we recommend the EZDC establish separate general ledger accounts and files to segregate the accounting for such grant from the Title XX EZ SSBG activities. We also recommend the EZDC determine its costs for the MBOC program and take action to cover such costs with non-Title XX funds, to the extent such funds are available.